Chapter 2
Export Credit Insurance for Banks

2.1 Whole Turnover Covers

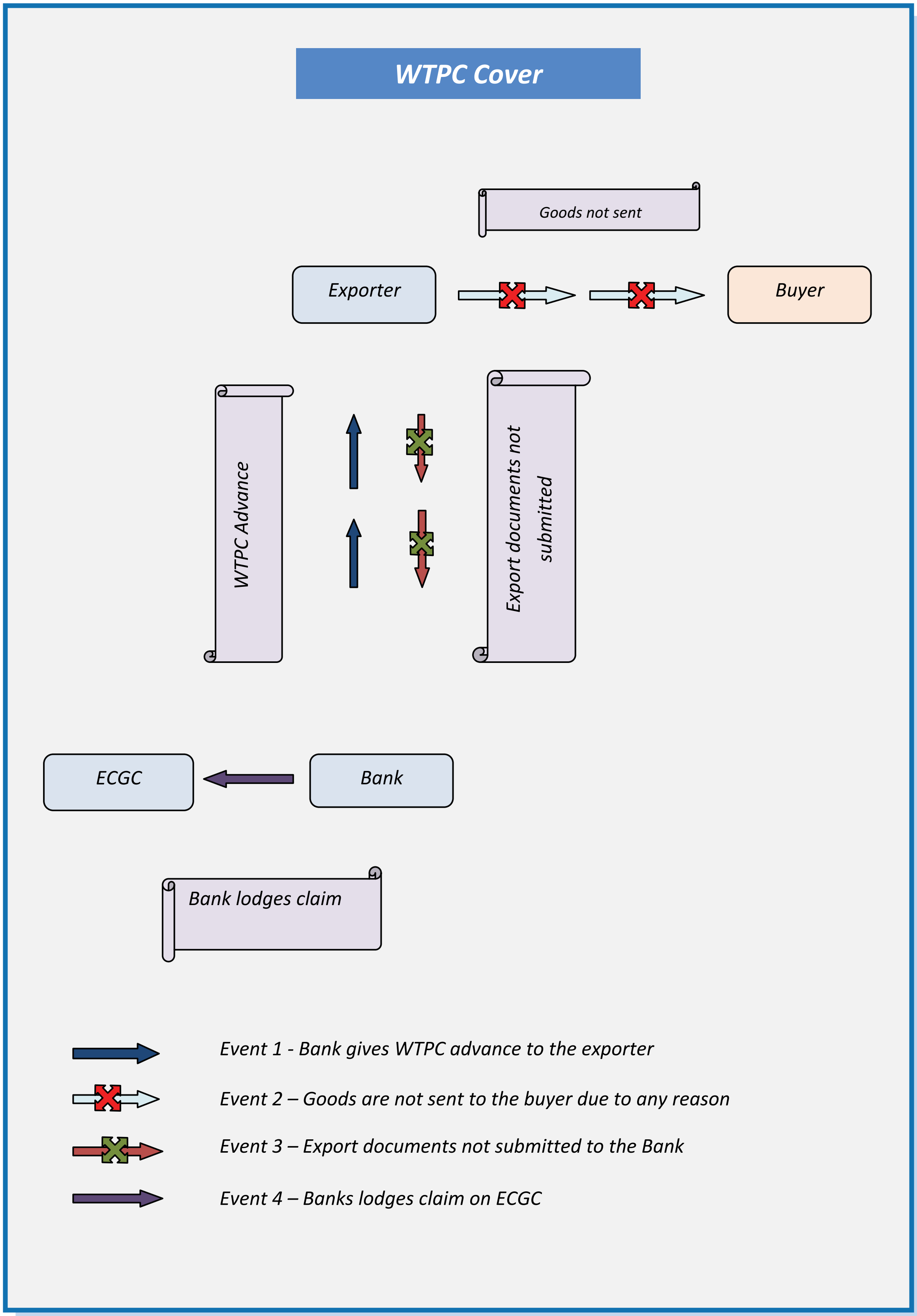
The scheme of export financing by the Banks was introduced in 1967. The financial assistance was provided by Banks to the exporters at two stages. The first was by way of Packing Credit (PC) for working capital to purchase raw material, processing, packing and warehousing of goods meant for export. The second stage namely, Post Shipment (PS) finance was provided by the Banks against the shipping documents after liquidating the PC advances.

These advances to the exporters for PC and PS by the Banks had a risk of default and such a default would add to the Non-Performing Assets (NPA) of the Banks. The whole turnover covers offered by the Company protected the Banks against the default by the exporter who had availed PC or PS credit. The Banks were to be reimbursed at different rates varying from 50 to 95 *per cent* of the advances outstanding depending on the terms and conditions of the covers.

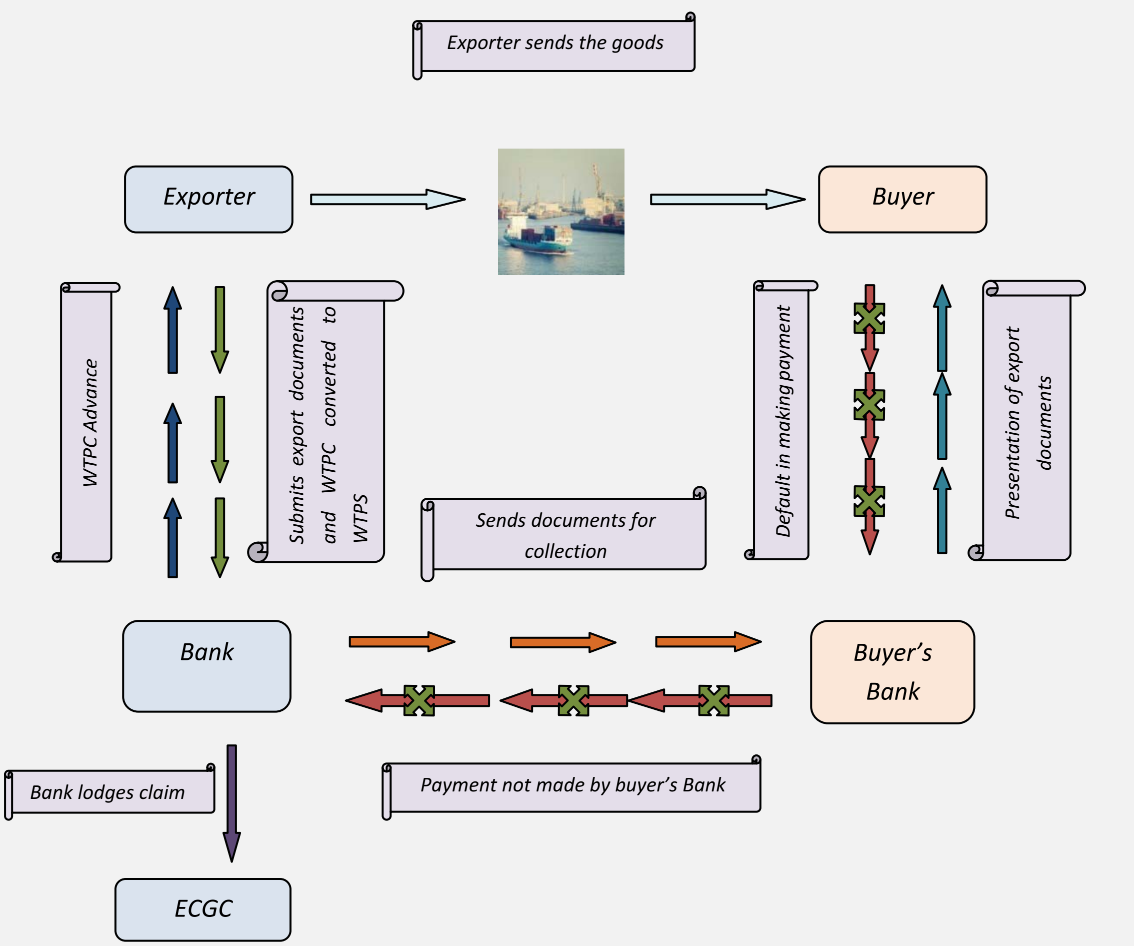
The Whole Turnover PC/PS (WTPC/WTPS) covers issued to the Banks automatically covered all the advances given to the exporters except those with previous history of default. In other words, the Banks got insurance cover for the advances extended to all the exporter/account holders who were regular in servicing their debt. In case of any fresh default by such exporters, the Banks got the money back from the Company. In effect, these defaults did not increase the NPA of the Banks.

Under the capital adequacy framework (BASEL requirement), Banks were to provide a minimum capital of 9 *per cent* on their risk weighted assets. However, the PC and PS advances against which insurance cover was given by the Company to the Banks were treated as risk free to the extent of 80 *per cent*. Thus, the Banks were required to meet the capital requirement for the balance of 20 *per cent* of the outstanding dues, which translated to 1.80 *per cent* only.

The process flow of the WTPC and WTPS insurance covers provided to the Banks is depicted in the following charts:



WTPS Cover



Event 1 -Bank gives WTPC Advance to the exporter

Event 2 - Exporter sends the goods to the

Event 3 - Exporter submits the export documents and WTPC is converted to

Event 4 - Bank sends export documents for collection to Buyers' Bank

Event 5 - Buyer's Bank present the documents to the buyer for payment

Event 6 - Buyer defaults in making payment; Buyer's Bank intimates

Event 7 - Bank lodges claim on ECGC

2.2 Performance of Whole Turnover covers

The Company's main ECIB business came from WTPC and WTPS as together they constituted 75-78 *per cent* of the total ECIB premium and 64-96 *per cent* of total ECIB claims during the five years ending 31 March 2011, as can be seen from the details given below:

(₹in crore)

Product		2006-07	2007-08	2008-09	2009-10	2010-11	Total
WTPC	Premium	230.14	250.48	263.76	268.69	293.27	**1306.34**
	Claims	154.17	176.08	141.48	126.84	126.79	**725.36**
	Recovery	116.07	93.45	105.57	80.11	74.2	**469.4**
	Net Claims	38.1	82.63	35.91	46.73	52.59	**255.96**
WTPS	Premium	76.01	76.48	87.94	96.83	106.3	**443.56**
	Claims	81.19	92.93	49.72	209.88	302.73	**736.45**
	Recovery	29.15	35.01	32.83	25.51	26.14	**148.64**
	Net Claims	52.04	57.92	16.89	184.37	276.59	**587.81**
Total of WTPC+WTPS	Premium	306.15	326.96	351.7	365.52	399.57	**1749.9**
	Claims	235.36	269.01	191.2	336.72	429.52	**1461.81**
	Recovery	145.22	128.46	138.4	105.62	100.34	**618.04**
	Net Claims	90.14	140.55	52.8	231.1	329.18	**843.77**
ECIB short term covers	Premium	396.69	429.76	464.18	486.78	510.62	**2288.03**
	Claims	245.15	285.86	234.19	371.69	459.63	**1596.52**
	Recovery	151.71	133.88	151.29	110.87	110.65	**658.40**
	Net claims	93.44	151.98	82.9	260.82	348.98	**938.12**
Whole turnover covers to ECIB short term covers (in *per cent*)	Premium	77.18	76.08	75.77	75.09	78.25	**76.48**
	Net Claims	96.47	92.48	63.69	88.61	94.33	**89.94**

Higher net claims affect the profitability of the Company adversely. During the last five years period, the premium under WTPC was more than the net claims and hence WTPC generated surplus. This would mean that the Company gained from the covers insuring pre-shipment advances by the Banks. WTPS generated surplus only during 2006-07 to 2008-09. However, due to a sudden surge in claims under WTPS, which cover post-shipment advances by the Banks, it turned out to be loss making during 2009-10 and 2010-11. Also, while the recovery[9] under WTPC was 64.71 *per cent* of the claims, it was only 20.18 *per cent* of the claims under WTPS.

Detailed scrutiny of these two products during the period 2008-09 to 2010-11 indicated that the Company issued 108 WTPC covers to 36 Banks and 92 WTPS covers to 31 Banks (five Banks did not avail WTPS covers). A review of 102 covers issued to 34[10] Banks under WTPC and 86 covers issued to 29 Banks under WTPS showed that there was a profit of ₹ 665.78 crore under WTPC and a loss of ₹ 191.72 crore under WTPS during the above period. An analysis of the losses posted by the Company under WTPS during the three year period indicated that many of the claims could have been avoided had the Banks observed due diligence and enforced the compliance to their sanction conditions. The Company did not enforce observance of prudence by Banks through enabling provisions in its covers and paid claims despite their adverse effects on its finances as discussed in the ensuing paragraphs.

The Ministry in its reply (June 2012) stated that:

- *historically, the claim incidence was always under WTPC, the situation under WTPS was adverse since 2008 onwards due to global meltdown. There were non-payments by buyers from developed countries. The loss under WTPS for two years (2009-10 and 2010-11) was only a temporary aberration due to global crisis and cannot be linked to any flaw in the scheme.*
- *various measures were taken to bring down the losses under WTPS like requirement of Banks to take prior approval of the Company in cases of larger exposures under diamond sector, restriction on limit exposures and percentage covers for iron ore sector and*
- *claims were not admitted where Banks had substantially violated their own sanction terms and conditions.*

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[9] ***A recovery would mean recovery of amount paid as insurance claim from buyers or other collaterals.***

[10] ***Data on underwriting not readily available for one Bank while the other Bank i.e. SBI availed only sectoral cover.***

The reply of the Ministry was in contrast to the following facts:

- An analysis of the data on premium and claims paid during the nine year period 2002-03 to 2010-11 showed that WTPC had always produced surplus (overall ₹ 1369 crore) with high recovery performance, while WTPS had sustained losses in five out of nine years (overall net loss ₹ 192 crore). Thus, the risk in respect of WTPS was higher as compared to WTPC and hence needed to be addressed.

- The steps taken by the Company to bring down the losses did not yield the desired effect in 2011-12 also. Out of ₹ 177 crore claim pay out in 2011-12 under WTPS, Gems and Jewellery accounted for ₹ 163 crore (92 *per cent*). Another ₹ 50 crore was outstanding for payment in 2012-13.

2.2.1 Non-loading for adverse claim experience under WTPS

During the period 2008-09 to 2010-11, under WTPC coverage, the Claim Premium Ratio (CPR)[11] was above 200 *per cent* for 2 out of 34 Banks with a loss of ₹ 26.62 crore. Contrasting this, under WTPS, CPR was more than 200 *per cent* in respect of 13 out of 29 Banks with a loss of ₹ 309.27 crore, as detailed below:

(₹ in crore)

Sr. No.	Name of Bank	2008-09				2009-10				2010-11				Total loss
		Premium	Net claims[12]	Profit/ Loss (-)	CPR (In *per cent*)	Premium	Net claims[12]	Profit/ Loss (-)	CPR (In *per cent*)	Premium	Net claims[12]	Profit/ Loss (-)	CPR (In *per cent*)	
1	**Axis Bank**	4.07	0	4.07	0	4.01	4.33	-0.32	108	4.1	61.47	-57.37	1499	-53.62
2	**Karnataka Bank**	3.32	3.63	-0.31	109	2.91	34.3	-31.4	1179	3.57	25.39	-21.82	712	-53.53
3	**ING Vysya Bank**	3.72	0	3.72	0	2.7	-0.16	2.86	-6	2.54	33.3	-30.76	1309	-24.18
4	**Dena Bank**	3.49	3.77	-0.28	108	3.76	45.2	-41.42	1202	4.04	10.44	-6.4	259	-48.1
5	**Saraswat co-op Bank**	2.86	0.11	2.75	4	1.61	9.25	-7.64	575	1.1	11.96	-10.86	1089	-15.75
6	**Bank of India**	7.44	-0.4	7.8	-5	5.96	48.1	-42.13	807	8	4.33	3.67	54	-30.66
7	**Oriental Bank of Commerce**	4.81	2.41	2.4	50	5.23	7.07	-1.84	135	5.58	21.77	-16.19	390	-15.63
8	**UCO Bank**	3.98	-1.3	5.27	-32	3.81	-0.26	4.07	-7	3.83	27.04	-23.21	706	-13.87
9	**Union Bank of India**	10.7	11.7	-0.94	109	9.42	15.1	-5.63	160	8.7	28.54	-19.84	328	-26.41
10	**Syndicate Bank**	5.01	-1.5	6.48	-29	4.35	14.2	-9.87	327	4.26	15.19	-10.93	357	-14.32

[11] *Percentage of claim paid to the premium received*

[12] *Net claims = Claims less recovery*

Sr. No.	Name of Bank	2008-09				2009-10				2010-11				Total loss
		Premium	Net claims[12]	Profit/ Loss (-)	CPR (In *per cent*)	Premium	Net claims[12]	Profit/ Loss (-)	CPR (In *per cent*)	Premium	Net claims[12]	Profit/ Loss (-)	CPR (In *per cent*)	
11	**Laxmivilas Bank**	0.46	-0.6	1.04	-126	0.66	1.49	-0.83	226	0.66	4.12	-3.46	622	-3.25
12	**The South Indian Bank Ltd**	0.26	2.53	-2.27	973	0.26	-0.03	0.29	-12	0.27	0	0.27	0	-1.71
13	**Vijaya Bank**	2.08	-0.8	2.88	-38	1.94	-0.08	2.02	-4	1.9	15.04	-13.14	792	-8.24
	Total													**-309.27**

The gap between premium and claim was wide in 2009-10 and 2010-11. The Company's loss in respect of these Banks during the above two years is detailed below:

(₹in crore)

Sl No	Name of Bank	Year	Premium	Net Claim	Deficit
1	Axis Bank	2010-11	4.10	61.47	57.37
2	Karnataka Bank	2009-10	2.91	34.31	31.40
		2010-11	3.57	25.39	21.82
3	ING Vysya Bank	2010-11	2.54	33.30	30.76
4	Dena Bank	2009-10	3.76	45.20	41.42
		2010-11	4.04	10.44	6.40
5	Saraswat Co-op Bank	2010-11	1.10	11.96	10.86
6	Bank of India	2009-10	5.96	48.10	42.13
7	Oriental Bank of Commerce	2010-11	5.58	21.77	16.19
8	UCO Bank	2010-11	3.83	27.04	23.21
9	Union Bank of India	2010-11	8.70	28.54	19.84
10	Syndicate Bank	2009-10	4.35	14.2	9.87
		2010-11	4.26	15.19	10.93
11	Laxmivilas Bank	2009-10	0.66	1.49	0.83
		2010-11	0.66	4.12	3.46
12	Vijaya Bank	2010-11	1.90	15.04	13.14
	Total		**57.92**	**397.56**	**339.63**

As seen from above, there was a surge in claims during 2009-10 and 2010-11 signifying that the exposures taken by the Company needed to be monitored. The CPR widely varied from Bank to Bank. In fact it ranged from 973 *per cent* to (-) 126 *per cent* in 2008-09 and from 1202 *per cent*[13] to (-) 12 *per cent* in 2009-10. Similarly in 2010-11, the CPR ranged from 1499 *per cent* to Nil *per cent*. The premium in respect of WTPS cover was borne by the Banks and Company's action to allow the Banks very high claim ratio, without adequate loading in the premium, resulted in unintended benefit to them.

It was observed that the Company, while renewing the covers, considered data on premium, claim paid etc. relating to previous five years without any disincentive for bad performance for any year and vice versa. This deflated the spikes in the CPR during the two years. In majority of cases, it was seen that the average CPR for three years (2008-09 to 2010-11) was much higher than the average CPR of five years (2006-07 to 2010-11). Thus, adoption of five years average CPR did not have the pinching effect on the Banks to adopt prudent practices to bring down the claim ratio.

In July 2010, one of the Directors suggested in the meeting of the Board that the Company could consider differential premium rates for Banks on the basis of their respective CPR, if warranted. Subsequently, the Company introduced (May 2011) a differential rate of premium, according to which the premium rate ranging from 5.5 paise to 7.00 paise per ₹ 100 was to be charged under WTPS depending upon the CPR.

However, it was observed that even this differential rate structure for WTPS was lower than that of WTPC which ranged from 6 paise to 10 paise per ₹ 100. Further, there was no denial of acceptance of risk for CPR beyond 400 *per cent* as was there in case of WTPC.

The Company stated (May 2012) that:

- *adoption of five year claim ratio was to avoid an increased premium burden on the exporters in WTPC and the same period was adopted for WTPS for uniformity;*
- *in most of the G-11 and other countries, the losses on account of export credit insurance were borne by the respective governments through official Export Credit Agencies to sustain export of their countries and hence spread of five years was considered logical.*

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[13] ***A positive CPR percentage denotes adverse CPR as claims are higher than the premium paid.***

The Ministry in its reply stated (June 2012) that:

- *the Company's intention was not to have any pinching effect on the Banks so that flow of credit to export was not affected. It was for RBI to have a system of recognition of penalty to reflect good and bad performance of Banks.*
- *a spread of five years to arrive at the CPR was considered logical and appropriate as steep increase in claims in any particular year would have a milder impact.*
- *WTPC covers carried a higher risk as compared to WTPS. The claim settlement under WTPC had been invariably higher than WTPS for the last several years except for 2009-10 and 2010-11.*
- *BOD did not suggest that the premium rates of the two covers be aligned but the number of slabs under WTPS be aligned.*
- *the percentage cover under WTPS was low as compared to WTPC.*

The replies are to be seen in the light of the fact that:

- the flow of credit was to be ensured by RBI and the Company's role was limited only to provide credit insurance to the Banks. It was not prudent on the part of the Company to bear the burden of the bad performance of Banks in terms of credit management.
- the adoption of five year average was not in line with the practice followed by other General Insurers[14], who were normally adopting three year CPR.
- the performance of the two products during the last nine year period (2002-03 to 2010-11) showed that WTPC resulted in surplus of ₹ 1369 crore whereas WTPS resulted in net loss of ₹ 192 crore during this period. Further, WTPC was profitable in each of the nine year whereas WTPS sustained losses during five out of nine years. The recovery performance under WTPC was also very high (46 *per cent* as against 18 for WTPS). Thus, the Company was exposed to more risk under WTPS. Therefore, WTPS needed to be priced appropriately.

Thus, there was a need for putting in place an effective system of incentives and disincentives under WTPS for containing the adverse claim ratio.

[14] *e.g. The New India Assurance Company Limited*

2.2.2 Claims under WTPS

Audit test checked 29 major WTPS claims totaling ₹ 371 crore paid by the Company during 2008-09 to 2010-11. Out of these, 26 claims for ₹ 347 crore related to export of diamonds under consortium arrangements. 17 claims amounting to ₹ 278.43 crore related to only four exporters. Four consortiums involving nine member Banks[15] covered by the Company extended 477 advances to these four exporters for exporting diamonds. Details are at the following table.

(₹ in crore)

Sl No	Name of lead Bank	No. of other consortium members	Name of the exporter	Number of advances	Amount	No. of claims	Amount of claims paid
1	Dena Bank	6	Niru Impex	209	144.98	4	89.25
2	Bank of India	5	Kalsaria diamonds	105	133.53	5	77.61
3	SBI	12	J.B.Diamonds	89	148.76	3	63.48
4	Union Bank of India	4	Mukund Gems	74	91.60	5	48.09
Total				**477**	**518.87**	**17**	**278.43**

Audit carried out a detailed check of 14 claims out of these 17 claims. These 14 claims involved 310 advances for diamond export to 61 foreign buyers and claim payment of ₹ 203.81 crore by the Company. In case of 40 foreign buyers there were repeated cases of default in payment resulting in default in repayment of multiple advances taken by the exporters from the Banks. The total default in 289 advances amounted to ₹ 367 crore and it resulted in claim outgo of ₹ 192 crore for the Company. The number of such defaults ranged from 2 to 27 for these 40 buyers. Six of these defaulted in payment of more than 10 advances resulting in payment of claims of ₹ 58.72 crore.

(₹ in crore)

Sl No	Name of exporter	Name of buyer	No of Banks	No of advances	Amount of advances	Amount of claim paid
1	Niru Impex	i) Niru Creations	3	27	7.61	4.07
2	Kalsaria diamonds	ii) Gem Gold International (HK)	4	14	16.44	9.86

[15] *ING Vysya, Vijaya Bank, UCO Bank, AXIS Bank, Bank of India, Dena Bank, Karnataka Bank, Union Bank of India, Allahabad Bank*

Sl No	Name of exporter	Name of buyer	No of Banks	No of advances	Amount of advances	Amount of claim paid
3	J.B.Diamonds	iii) Sugem (HK) iv) Chan Nit Trading Co (HK)	3 2	21 11	37.19 22.30	16.32 7.21
4	Mukund Gems	v) Diam star (HK) vi) Diamond Collection (HK)	4 3	22 11	28.99 11.05	15.25 6.01
Total				**106**	**123.58**	**58.72**

The Banks disbursed 240 out of 310 advances amounting to ₹ 322.67 crore to these exporters for export to Hong Kong based buyers, the default of which resulted in claim payout of ₹ 170.10 crore. It was noted in audit that the same individuals were figuring as CEO for different buyers based at Hong Kong. This in effect meant that the risk was not only concentrated at buyer level but also at individual level. The table below indicates the steep concentration of risk at the individual level and incidence of claim for ₹ 67.21 crore in respect of these individuals:

(₹in crore)

Sl. No.	Individual name S/Shri	Appearing in the buyer report as owner/CEO	No of advances	Amount of advance	Claim paid
1	Bhupendra Jivrajbhai Surani	Global Trend International	9	13.27	5.76
		J.B.Collection	9	18.98	8.65
		J.B.Jewellery	6	12.87	6.13
		Sugem	21	37.19	16.32
2	Laxman Dattaram Dalavi	Gem Diam	10	11.11	6.42
		Krishna Jewels	8	11.16	6.47
		Kristal Designs	11	11.17	6.39
3	Rohit Dusad	Kowloon Impex	8	16.69	10.01
		Reva Trading	1	1.46	1.06
Total			**83**	**133.90**	**67.21**

In addition to the risk of concentration in consortiums highlighted above, audit also observed lack of co-ordination amongst consortium members. During January 2009 to November 2009 four consortium member Banks made 10 post shipment credits of ₹ 12.83 crore to four exporters in respect of foreign buyers, who had already defaulted in repayment of seven advances for ₹ 7.15 crore within due date/extended due date.

It was observed that in some of the cases involving consortium arrangements, the Company came to know of the same only at the time of filing of the Report of Default by the exporters. Thus, in effect the Company, while underwriting the WTPS cover, did not assess the concentration of risk to the extent that Company was not even aware of the existence of these arrangements amongst Banks.

The Company in reply (March 2012) stated that the matter of co-ordination among various consortium members, was to be dealt with by RBI[16] and not by them.

The Ministry while endorsing (June 2012) the reply of the Company further stated that various initiative have been taken by the Company to curb losses in the gem, jewellery and diamond sector which had resulted in lower claim of ₹ 530 crore in 2011-12 as against ₹ 606 crore in 2010-11. Moreover, it was stated that the Company had since introduced prudential norms for exposures, linked to the net worth of ECGC.

The reply of the Company demonstrates that this serious threat to its financial condition due to default by any one individual was not adequately evaluated and steps were not taken to mitigate the probability of loss.

It was the responsibility of the Company to map all the risk exposures and provide for adequate risk mitigation measures. Moreover, the risk exposure arising out of concentration of risk at commodity, region or individual level cannot be mitigated unless the Company is aware of the arrangements among the various Banks at the time of underwriting itself. Apart from the fact that the claims of ₹ 530 crore were still very high, the reply of the Ministry was silent about the high exposure level during the period.

2.2.3 Inadequacies in buyer verification

The WTPS covered all the account holders availing the credit facility from the Banks. Some of the accounts holders could be policy holders (having short term policy with the Company). The risk of default in respect of account holders, who were also policy holders, had already been assessed and credit limit fixed by the Company. However, in respect of non-policyholders, the Banks were required to take suitable safeguards like obtaining credit reports and satisfy that the payments from the buyers were being received in the normal course.

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[16] *Reserve Bank of India*

In the earlier Performance Audit, the issue of inadequate verification of creditworthiness of buyers was raised. The Ministry in Action Taken Note (ATN) of January 2011 stated that the recommendation of audit to make verification of buyer credit worthiness mandatory for Banks was implemented.

During the present audit, this issue was reviewed in detail and it was observed that 111 out of 135 WTPS claims paid by the Company during 2008-09 to 2010-11 pertained to non-policyholders. In these cases, the Banks were responsible for verification. Audit scrutiny of 29 selected WTPS claims (all non-policy holders) amounting to ₹ 371 crore (69 *per cent* of ₹ 534 crore paid towards 135 claims.) indicated that out of 668 advances, the Bank branches had disbursed 574[17] advances to the exporters, without ensuring satisfactory buyer reports as detailed below:

(₹in crore)

Sl. No	Advances				Claims paid		
	Type of reports	No. of advances	Amount	Percent-age to total	No. of claims paid	Amount	Percent-age to total
1	Out-dated Reports[18]	125	145.25	21.42	29	79.39	21.39
2	Post-dated Reports[19]	71	81.29	11.99		46.86	12.63
3	Unsatisfactory Reports[20]	133	162.47	23.96		87.54	23.59
4	Clear Reports[21]	94	105.81	15.61		54.96	14.81
5	Nil Reports[22]	245	183.15	27.02		102.34	27.58
	Total	**668**	**677.97**	**100.00**	**29**	**371.09**	**100.00**

In this regard, audit observed that:

- The Company issued ECIB covers to the Banks with a clause which required that due diligence be observed by the Banks in granting credit to the exporters;
- A stipulation was also made by the Company on the requirement of buyer verification in the covering letter to ECIB bond issued to the Banks;

[17] *Total no of advances minus clear reports i.e. 668-94 = 574.*
[18] *Any report obtained more than six months prior to the date of advance.*
[19] *Any report obtained after the date of payment of advance.*
[20] *Any report with nil rating due to inadequate information on the buyer or below average rating.*
[21] *Any report both relevant to the date of advance as well as satisfactory rating.*
[22] *Report not obtained by Banks.*

- Majority of Banks made buyer verification a pre-condition for compliance by their branches before granting advances to the exporters;

- Two export promotion bodies (Exporters India and Textiles Indepth) also observed (April 2012) that in case of Non-LC exports, bank financing was totally dependent on the credit worthiness of the buyer besides the exporter.

Yet, advances were disbursed by the branches of Banks on the basis of outdated, post-dated, unsatisfactory or nil buyer verification reports. Thus, there was lack of due diligence and non-compliance with the stipulations made by the Company in the covering letter to the ECIB Bond on the part of the Bank branches. No certificate regarding exercising of due diligence by the Banks was ever insisted by the Company before payment of claims. Despite the laxity on the part of the Bank branches, the Company paid claims of ₹ 316.13 crore[23].

The Company in reply stated (March 2012) that:

- *it was not practical to stipulate such conditions mandatory for all sectors as Banks followed their own credit appraisal norms/standards;*

- *it had no intention of imposing the condition of obtaining overseas buyer reports in its cover since the risk covered was default of the exporter and not the buyer;*

- *based on adverse claim experience with regard to gem, jewellery and diamond sector, obtaining satisfactory buyer reports was made mandatory for limit approvals from December 2009 onwards;*

- *there were umpteen instances where the Company disallowed many post shipment advances on the ground of out-dated / post-dated / unsatisfactory reports.*

During the Exit meeting in March 2012, the Management further elaborated that both the GOI and RBI were taking a liberal view for extending credit to exporters, Banks were allowed to advance even without firm order and Banks had to necessarily discount the bills presented by the exporters even if the buyer verification showed inadequacies after the grant of packing credit advances.

[23] ***Total claims less claims paid towards clear reports i.e. ₹ 371.09 - ₹ 54.96 crore = ₹ 316.13 crore***

The Ministry in its reply further added (June 2012) that:

- *even if the buyer failed to repay, the Banks had recourse on the exporter and it could not be concluded that the reason for non-payment was on account of the buyer report being out-dated or un-satisfactory or post-dated. Moreover, the entire account of the exporter-borrower was covered under ECIB and the claim would be lodged only if the entire account became NPA.*

- *subsequent to the audit recommendation for ensuring buyer verification, the Banks had informed that they were governed by RBI norms and their internal sanction terms normally stipulated conditions to the effect that they should obtain satisfactory credit reports on overseas buyers who were not associates. Making obtention of satisfactory report on the overseas buyer mandatory for discounting the bills for all sectors might not be practical and the banks might opt out of extending export finances, in the absence of covers from the Company.*

- *the Banks had to necessarily purchase the bills presented by the exporters, even if the buyer verification showed inadequacies.*

- *the Company erred in accepting audit recommendation made in the Performance Audit Report of 2008 regarding obtaining of satisfactory report on overseas buyer mandatory by banks for extending ECIB Covers to banks.*

However, it also stated that the Company would consider stipulating the condition relating to buyer verification for specific sectors in future, if warranted by circumstances.

The replies have to be viewed in the light of the following:

- As per the Company's manual, WTPS covered non-realization of export proceeds and resultant insolvency/protracted default of the exporter. Thus the performance of the foreign buyer was not delinked from the exporter and the risk basically rested on the financial position of the buyer.

- Though Banks were governed by the RBI norms, it is in the interest of the Company to have enabling provisions in their cover to guard against unmitigated risk falling to their account. Ensuring proper buyer verification by Banks would minimize the chances of default as well as loss to the Company.

- The Ministry in its ATN (January 2011) had stated that the earlier audit recommendation on the issue was implemented by the Company. However, the present endorsement of the Company's reply that they erred in accepting the recommendation showed weakness in governance. Further, the Banks' internal sanction terms did not distinguish an associate[24] from non-associate in the matter of buyer verifications.

- The Banks were under no obligation to discount the bills after knowing that the buyer report was unsatisfactory.
- The action taken by the Company in December 2009 referred to issue of an internal circular to its branch offices stipulating buyer verification for gem and jewellery advances, which was not legally binding on the Banks. Further, the audit recommendation was for all the commodities.
- Out of 574 advances for ₹ 572.16 crore in the last three years, where audit observed default by the exporters, the Company had disallowed only seven cases for ₹ 10.41 crore (1.82 *per cent*) on grounds of buyer reports.
- IRDA had vide its onsite inspection report (October 2011) on ECGC inter-alia commented on the unsatisfactory buyer reports.

Thus, the Company accepted the liability despite defective buyer reports rendering the system susceptible to be used as a conduit for transferring the NPAs of Banks. This ultimately resulted in the negative performance of the WTPS cover with a deficit of ₹ 187 crore during the three years ending 31 March 2011.

2.2.4 Injudicious underwriting

In some export transactions, the foreign buyers make advance payment to the Indian exporters for executing the contract and the same gets liquidated on satisfactory performance of the contract. However, the buyers in these cases generally require that the advance payment be guaranteed by Banks.

The Company through its Export Performance Advance Payment (EPAP) cover provided counter guarantee to the Banks against the guarantees so issued by them which protected the Banks against failure of the exporter in fulfilling the export obligation.

During 2008-09 to 2010-11, the Company issued 142 guarantees with a total risk value of ₹ 815.48 crore. Out of these, 45 guarantees were issued to Banks against the performance of an exporter M/s Zoom Developers Ltd, as detailed below:

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[24] *An associate means an overseas subsidiary or an associate of the exporter client of the Bank in which the exporter client has financial interest and/or operational/managerial control*

(₹in crore)

Year	Total No and value of guarantee		M/s Zoom Developers Ltd.	
	Number	Risk value	Number	Risk value
2008-09	75	571.53	35	494.32
2009-10	44	224.20	10	155.69
2010-11	23	19.75	Nil	Nil
Total	**142**	**815.48**	**45**	**650.01**

The Company was issuing these counter guarantees to the Banks relying on the assessment of creditworthiness of exporter by Banks and there was no system of independent evaluation of the exporter or their capacity to execute the contract.

The case relating to issuance of counter guarantees to the Banks in respect of M/s Zoom Developers Limited is discussed below:

M/s Zoom Developers Limited a medium sized project development and IT Company was involved in multi sector projects like process plants, chemical and petro chemical plants, steel plants, auto components, rehabilitation of water supply pipelines etc. The Company issued 193 counter guarantees for a value of ₹ 2114 crore during 2003 to 2009 to a consortium of 24 Banks led by Punjab National Bank in respect of the above exporter. These counter guarantees covered the advance payments received by the exporter from its foreign buyers for executing projects in different countries. However, 190 covers for ₹ 2066 crore were invoked (since March 2009 onwards) by the foreign buyers for non-completion of projects. Accordingly, the consortium of Banks made (February 2010 to April 2011) claims and the net claim liability likely to devolve on the Company worked out to ₹ 1047 crore. The Company after receipt of the claim, conducted (September 2011) inspection of records at the Banks and found that the part money received as advances initially, was sent back to the same entity who had given the advance. The inspection also revealed that ₹ 15 crore was transferred (September 2006) to entities not connected with the project. The Company rejected the claims of the Banks on the above ground. The matter was also being investigated (2011) by CBI[25] and a case was registered against the Director of M/s Zoom Developers Limited and others.

Though the Company had rejected the claims during March 2011 to October 2011, yet, the following omissions on the part of the Company in undertaking this risk required mention:

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[25] *Central Bureau of Investigation*

- The guarantee and counter guarantee was meant for a period of six months. However, in the instant case, the Company extended the counter guarantees for more than five years and simultaneously increased its exposure which is apparent from the following table:

(₹in crore)

Sl. No.	Period of issuance of guarantees	No. of guarantees / projects	Value of guarantees outstanding on September 2009	Percentage range of project completion
1	2003-04 to 2005-06	42	252.78	above 90
2	2004-05 to 2006-07	34	338.12	60-89
3	2005-06 to 2008-09	44	492.09	30-59
4	2006-07 to 2008-09	73	1031.27	0-29
	Total	**193**	**2114.26**	

The non-liquidation of counter guarantees issued in the earlier years, extension of the same and issue of fresh guarantees resulted in steep increase in claim value.

- The Company continued to increase its exposure limits from ₹ 285 crore in February 2004 to ₹ 1850 crore in March 2009 without obtaining the status of completion of the projects. The Company obtained status report on completion of the projects in September 2009, only after reporting of the claim by the Bank. As per the above report, in respect of 73 projects (₹ 1031 crore) out of 193 projects (₹ 2114 crore), the completion was only 0-29 *per cent*. The cumulative effect of this resulted in accumulation of risk in respect of the same party with a peak risk value of ₹ 1850 crore.

- The Company's maximum liability in this case was ₹ 1222 crore (February 2011) against which the reinsurance cover was available only for ₹ 175 crore (approximate) and the balance was to be borne by the Company.

- Though the Company's underwriting guidelines governing the counter guarantee covers stipulated that the value of bank guarantees given to the foreign buyers be reduced upon receipt of proceeds of exports, the same condition was not inserted by the Banks in the guarantee as revealed by a test-check. The underwriting could have been avoided had the Company taken note of the omission made by the Banks in the guarantees given by them.

The Company in reply (March 2012) stated it had issued the covers in good faith based on information provided by Banks in their proposal form. Further, it was stated that the claims had been rejected on account of serious fraud committed by the exporter and non-monitoring the end use of funds by the Banks in violation of RBI norms. The Company also stated that it had since initiated stricter risk mitigation measures/prudential norms such as fixation of limits for each exporter exposure, augmenting reinsurance covers, revisiting and strengthening ECIB/EP cover documents etc. During the Exit meeting, the Company assured to review and take corrective action to improve the form design of ECGC cover and also carry out verification of Bank's appraisal at the underwriting stage in respect of large EPAP covers.

The Ministry endorsed (June 2012) the reply of the Company regarding issuance of the cover under good faith and rejection of claim on account of fraud committed by the exporter.

The fact remains that the Company did not have an appropriate system of making an independent assessment of the risk while underwriting mega risks.

2.2.5 Non-issue of commodity specific covers for diamond exports

We observed that though the claim pay out in respect of gems and jewellery advances during 2008-09 to 2010-11 was maximum (₹ 432 crore out of total ₹ 534 crore), the decision of the BOD to issue commodity specific cover with proper premium rate was pending since 2002. The CMD had also observed (March 2011) the need for increase in premium rate for gems and jewellery and Company's corporate plan also provided for issue of such covers.

The Company in its reply (March 2012) stated that it was in discussion with Gem and Jewellery Export Promotion Council for introduction of suitable commodity cover.

The Ministry endorsed (June 2012) the reply of the Company.

2.2.6 Fixing of Maximum Liability

The Company at the time of underwriting the covers for WTPC and WTPS was also fixing the Maximum Liability (ML) separately for each of them. The ML signified the cap on the liability on the part of the Company towards the Bank. As per the ECIB manual of the Company, the ML was to be fixed for each Bank on the basis of aggregate advances (WTPC or WTPS advances) outstanding as on 31 March before commencement of the cover (July to June). We observed, in selected 33 covers of WTPC, where CPR was more than 70 *per cent*, the ML ranged from 9.55 *per cent* to 71.56 *per cent* of the aggregate outstanding advances. Similarly, in 33 covers of WTPS, where CPR was more than 70 *per cent*, the ML ranged from 5.46 *per cent* to 169.49 *per cent*. Thus, there was no uniformity in fixing the ML.

Further, the fixation of ML with reference to the aggregate of advances outstanding at the year-end only without appropriate formulae was flawed. The Company needed to cap its liability by assessing the risk for each Bank considering the factors like CPR, number of account holders, number of policy holders, number of Non-Performing Account holders with amount of outstanding from them etc.

The Company replied (March 2012) that it was in the process of formulating suitable methodology for fixing maximum liability under WT covers.

The Ministry replied(June 2012) that for the year 2012-13, ML was being fixed by the Company after taking into account three parameters viz. one third of total outstanding, 20-30 times of premium anticipated or received in previous year, ML approved for Banks with comparable business for the year 2012-13.

2.2.7 Advances for buyers in the defaulters list

In the event of default in payment by a buyer, the Company besides canceling the Overall Limit (OL) sanctioned on that buyer puts the buyer's name in the defaulters list also. The defaulters list was intended to caution other exporters on the financial condition of the buyer for appropriate action.

It was seen in audit that during April 2008 to July 2009, 18 Bank branches gave 40 PS advances amounting to ₹ 38.75 crore to ten exporters against four defaulted buyers, who had already been placed in defaulters list during November 2006 to September 2007. Though this was in violation of the due diligence clause of the ECIB cover granted to the

Banks, yet the Company paid claims of ₹ 23.40 crore in respect of these four buyers as detailed below:

(₹ in crore)

Sl No	Name of the buyer	Period of advances given	Amount of advance	Date of putting on defaulters list	Amount of claim
1	Kristal Designs, Hongkong	May 2008-Dec 2008	9.79	July 2007	5.70
2	Krishna Jewels, Hongkong	May 2008 to October 2008	7.68	November 2006	4.21
3	Gem Diam, Hongkong	July 2008 to December 2008	5.87	December 2006	3.69
4	Mohit Gems, Hongkong	April 2008 to July 2009	15.41	September 2007	9.80
Total			**38.75**		**23.40**

Four other buyers (C&H Dia Trading, HK Dia Trading Company, Hongkong, Phoenix Impex, Hongkong, Starlite Diamonds, Hongkong) who had defaulted in repayment of 26 PS advances during January 2009 to February 2010 for ₹ 33.11 crore and where the Company had paid ₹ 20.73 crore as claims, were not even placed in defaulters' list as of November 2011.

In reply, the Company stated (March 2012) that there was no pre condition in ECIB covers to prevent Banks from discounting bills drawn on a buyer who figured in BSAL[26] (defaulter list).

The Ministry stated (June 2012) that the risk covered was default of the exporter and not foreign buyer. It further stated that ECGC could not impose very strict restrictions as various entities could claim damages for loss of reputation as there could be disputes, at times, with Indian exporters and buyer's name would get included in the list for no fault of his.

Audit is of the view that as per the terms of the ECIB cover, Banks were bound to exercise due diligence in granting credit to exporters and thus they should have referred to the defaulters list of the Company as disbursement of advances to exporters for shipment to buyers who had figured in the defaulters' list was an adverse risk. The apprehension that various entities could claim damages is unfounded, as the audit

[26] *Buyer Specific Approval List*

committee of the Company had taken a decision way back in July 2009, after obtaining opinion of their legal department, to circulate the names of the defaulting buyers among Banks so as to avoid any further risks on such buyers. Also, though the Company stated that very strict restrictions (like putting in BSAL list) could not be imposed as it could lead to litigation by the buyers, it had imposed the same condition for coverage under Gems and Jewellery sector. Therefore, the reply is contradictory.

2.2.8 Settlement of claims in WTPC involving stock

The PC extended by Banks to the exporters was primarily secured through hypothecation of stocks. The claim for WTPC by Banks on the Company was made on non-discounting of export bills by the exporter. We observed that the Company settled (2008-09 to 2010-11) eight claims of Banks amounting to ₹ 84.21 crore in respect of WTPC cover without ascertaining the latest position of availability of the stock with the exporter. The Banks referred to stock reports in the claim form which were one to thirteen months old on the date of filing of the claims, as detailed hereunder:

Sl. No	Name of exporter	Claim made on	Month of last stock report
1	Sheena textiles	03.01.2009	12/2007
2	Jeevanlal & sons	17.09.2007	07/2007
3	Sonal garments (Corporation Bank)	26.02.2010	06/2009
4	Sonal garment (ING Vysya Bank)	07.01.2010	09/2009
5	J.B.Diamonds	14.10.2010	06/2010
6	Elite International (Saraswat Co-op Bank)	05.09.2008	06/2008
7	Elite International (Axis Bank)	19.09.2008	08/2008
8	Lalit Polyesters	13.12.2010	08/2010

On account of non consideration of the latest stock report by the Company, the possibility of unauthorised disposal of stocks by the exporters could not be ruled out.

In this regard, it was observed that Section 64 UM (2) of Insurance Act 1938, stipulated that no claims in excess of ₹ 20,000 in respect of a loss which occurred in India could be paid without a report from the surveyor about the loss. Had the Company complied with this requirement while settling the claims under WTPC, it would have had first hand knowledge of the availability and value of stock with the exporter rather than depending upon the outdated stock reports mentioned in the claim forms filed by the Banks.

During the Exit meeting when the issue regarding non-appointment of surveyor under Section 64 UM (2) was raised, the Company stated that this section was not applicable to them.

The Ministry, however, replied (June 2012) that the Company had written to IRDA in June 2012 seeking exemption/waiver from the relevant provisions of the Insurance Act 1938 as it was for the Banks to ensure protection of stocks charged to them and enforce realization of the same.

In view of the fact that there was no specific exemption obtained from IRDA by the Company, the settlement of claims without engaging the surveyor was not in order.

2.2.9 Staff accountability issues

Any loss to the Bank due to an act of omission and/or commission on the part of the Bank officials was excluded from the cover given by the Company. Accordingly, at the time of claim submission to the Company, Banks were required to give an explicit undertaking that either there was no omission or commission on the part of their officials or an investigation was under progress. The Banks undertook to refund the entire claim amount in the event of any official found guilty of malafide, negligence or irregularity.

The above issue was raised in the earlier Performance Audit Report, wherein it was recommended that the Company needed to institute a system for regular in-house consolidated reporting and follow-up of claims involving accountability issues besides ascertaining its dues, if any, arising out of such cases. The Ministry also accepted (January 2009) the above recommendation and stated in ATN (January 2011) that the Company had implemented the same.

The implementation of the above recommendation was reviewed during the present audit and it was observed that the computerised system implemented for capturing the data regarding staff accountability issues did not have any provision to capture the data regarding internal enquiry, if any, in progress. Further, there was no provision in the system to consolidate the data at Head Office level. As a result, the Company manually compiled the data with only number of cases on the basis of information sent by its branch offices. Data regarding money value and age-wise/investigating agency-wise analysis of the cases where enquiry was going on was also not available with the Company.

Audit observed that as of March 2011, there were 138 pending staff accountability issue cases. It was seen that in Ahmadabad branch alone there were 93 cases pending as on November 2011 as detailed below:

(₹in crore)

Age-wise analysis	No. of pending cases	Pending recovery
Upto 1 year	1	4.15
1 year to 3 years	17	43.33
3 years to 5 years	14	22.41
5 years to 10 years	60	66.08
More than 10 years	1	1.48
Total	**93**	**137.45**

It may be seen from the above table that 60 pending cases for ₹ 66.08 crore were between 5 to 10 years of age. The branch did not reply to an audit query regarding periodic follow-up of these cases with the Banks.

Taking into account the above, the Company needed to address the deficiency in capturing the data in the system for effective monitoring. The pending staff accountability cases also needed to be closely monitored.

The Company stated (March 2012), that the format of undertaking was designed in consultation with Indian Banks Association and the same would be reviewed and suitably modified, if required.

The Ministry while endorsing (June 2012) the reply of Company regarding revision of format of undertaking, further stated that the Company had advised its branches to vigorously follow up the cases, obtain necessary information and to report the same to Head Office. It was further informed that the Company was setting up a separate recovery cell at HO and follow up of staff accountability would be a part of the work entrusted to the cell.

2.2.10 Recoveries of claims settled

After settlement of claims, branches of the Company were required to pursue the recoveries with the Banks and branch-wise targets were also set in this regard. We observed that pending recoveries had gone up from ₹ 2170 crore in 2008-09 to ₹ 2333 crore in 2009-10 and further to ₹ 2628 crore in 2010-11. The actual recoveries made during these years also declined from ₹ 151.29 crore in 2008-09 to ₹ 110.65 in 2010-11 which was indicative of inadequate recovery efforts. The age-wise detail of the pending recoveries was not on record.

In reply, the Company stated (March 2012) that the recoveries being effected in ECIB were considered reasonable in the light of the fact that the Banks were not insisting upon material collaterals where ECIB covers were available. It also stated that the collateral securities obtained by the Banks were meant for all facilities sanctioned to an exporter by the Bank and not exclusively for the facilities under ECIB.

The Ministry stated (June 2012), that the Company was setting up a separate recovery cell to consolidate recovery efforts of branches. It was further stated that the reduction in ratio of recovery to outstanding amount was also due to not writing off very old cases and efforts would be taken to improve the ratio.